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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re: **PACIFIC GAS AND ELECTRIC COMPANY,** Debtor.	Case No.: 01-30923 Chapter 11 Date: March 25, 2002 Time: 9:30 a.m. Court: Hon. Dennis Montali 22nd Floor, 235 Pine Street San Francisco

UNITED STATES TRUSTEE'S OBJECTION TO MOTIONS TO APPROVE (1) SETTLEMENT AND SUPPORT AGREEMENT (2) PAYMENT OF CERTAIN PRE-PETITION CLAIMS

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Linda Ekstrom Stanley, United States Trustee, objects to the Proponents' motion to approve the settlement and support agreement between the debtor, its parent and a majority of the members of the unsecured creditor class (Class 5) and debtor's motion to pay claims under $5,000 immediately. The Bankruptcy Code does not authorize the Bankruptcy Court to approve the relief requested by either of these motions.

The proposed settlement with the Senior Debtholders[1] is presented as a "compromise" of a controversy – that is, a settlement of a dispute between the parties over what interest rate will have to be paid to creditors by this solvent estate under a confirmed plan. But the terms of the extraordinary settlement far exceed the resolution of the narrow interest rate issue. The Proponents' request to approve the settlement with the pre-petition, unsecured Senior Debtholders offends important principles of bankruptcy law. The settlement calls on the debtor to pay interest to unsecured *pre-petition* creditors in advance of a Bankruptcy Court-confirmed plan of reorganization. A second provision requires creditors to vote "yes" on the Proponents' Plan of Reorganization. Another provision affirmatively prevents creditors from taking any action, direct or indirect, to develop or formulate an alternative plan. These terms cannot be approved. Chapter 11 prohibits payment of pre-petition claims outside a confirmed plan. It also prohibits solicitation of votes prior to the Bankruptcy Court's approval of a disclosure statement.

Debtor's motion to pay small unsecured pre-petition claims shares similar faults. Convenient as early payment of these claims may be, no provision of the Bankruptcy Code authorizes the Bankruptcy Court to authorize payment of unsecured claims prior the confirmation of a plan. On the contrary, payment of claims must await a vote of creditors accepting the terms of a plan and the Court's determination a plan meets the exacting standards of 11 U.S.C. § 1129. The Proponents' bald assertion that payment is authorized by 11 U.S.C. § 105 because of the supposed latitude § 105 is said to give Bankruptcy Courts must be rejected because the Bankruptcy Code makes no provision for early payment of claims.

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[1] Capitalized terms have the same meaning attributed to them in the Second Amended Plan of Reorganization or the Proponents moving papers.

BACKGROUND

Debtor (individually and with its corporate parent) submitted two novel but extra statutory motions for court approval. The first, styled a *Motion by Pacific Gas and Electric Company for Order (A) Approving Settlement and Support Agreement, etc.*, seeks Bankruptcy Court approval of the Settlement and Support Agreement between the Proponents and a majority of the Class 5 unsecured creditor class. The agreement would authorize the estate to pay interest on pre-petition claims at a negotiated rate prior to confirmation of any plan of reorganization. The document requires debtor to pay both the pre-petition and post-petition costs (legal and otherwise) of the Senior Debtholders immediately or when incurred. The Settlement and Support Agreement, negotiated prior to the approval of any disclosure statement, prior to the termination of exclusivity by the Bankruptcy Court, and prior to filing of a term sheet by the only competing plan proponent, is conditioned by the Proponents on *absolute* acceptance by the Senior Debtholders of the Proponent's plan. The provision implementing this agreement could not be more broadly worded:

> The Senior Debtholders shall fully support confirmation of the Plan, and each Senior Debtholder shall: (i) following review of an approved Disclosure Statement and solicitation package, vote its Allowed Class 5 Claim(s) set forth on Schedule "A-1" hereto, and any further Class 5 Claims that it may acquire. . . in acceptance of the Plan; (ii) *fully support confirmation* of the Plan; (iii) *not consent to, vote for, or otherwise support*, encourage, directly or indirectly, any plan of reorganization . . . other than the Plan; (iv) *not take any actions, directly or indirectly*, to begin development or formulation of a plan of reorganization . . other than the Plan; (v) *not solicit, directly or indirectly*, or meet with any parties, for the purpose of developing or formulating a plan of reorganization other than the Plan; and (vi) *not object to, delay or impede* or otherwise commence any proceeding to oppose or object to the Plan or the Disclosure Statement.

Settlement and Support Agreement ¶ 13(a) (emphasis added).

The second motion, styled *Motion for Authority to Pay Certain Categories of Pre-Petition Claims* requests Bankruptcy Court approval for debtor's proposal to pay all pre-petition claims of less than $5,000 in advance of any plan confirmation. These creditors are not asked to surrender their right to vote on the plan in consideration.

Neither motion takes any account of the competing plan the CPUC is filing on April 15, 2002.

ARGUMENT

I. THE PROPONENTS' SETTLEMENT WITH THE SENIOR DEBTHOLDERS CANNOT BE APPROVED BECAUSE IT EXCEEDS THE COURT'S AUTHORITY UNDER SECTION 363(b) AND BANKRUPTCY RULE 9019

A. Section 363 Does Not Authorize Approval of Agreements Requiring Creditors To Vote In Favor of A Plan

Proponents rely on Bankruptcy Code § 363 and Federal Rule of Bankruptcy Procedure 9019 in support of their request for approval of the Settlement and Support Agreement. Neither § 363 nor Rule 9019 authorizes this result. Section 363 permits the trustee to "use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b). No interpretation of these words could authorize the Bankruptcy court to approve an agreement requiring creditors to vote in favor of the Proponents' plan.

Not surprisingly, courts have found § 363(b) does not permit a settlement requiring a particular vote on a plan. In one important case not found in the moving papers, *In re Braniff Airways, Inc.* 700 F.2d 935 (5th Cir.), *reh'g denied sub. nom Pension Ben. Guar. Corp. v. Braniff Airways, Inc.*, 705 F.2d 450 (5th Cir. 1983), the Fifth Circuit refused to permit the debtor to do just what the proponents wish here: settle a matter and require a vote in favor of a plan. The Fifth Circuit held the proposed settlement exceeded the scope of § 363:

> [T]the secured creditors were required to vote a portion of their deficiency claim in favor of any future reorganization plan approved by a majority of the unsecured creditors' committee. [S]uch action is not comprised by the term, "use, sell, or lease" and it thwarts the Code's carefully crafted scheme for creditor enfranchisement where plans of reorganization are concerned.

In re Braniff Airways, Inc., 700 F.2d at 940. *See Official Comm. of Unsecured Creditors v. Cajun Electr. Power Coop., Inc. (In re Cajun Electr. Power Coop., Inc.)*, 119 F.3d 349, 354-55 (5th Cir. 1997) (Section 363 does not authorize approval of settlements which are "sub rosa" plans because they restrict creditors' votes on plans, among other things).

Rule 9019 authorizes the Bankruptcy Court to approve a settlement or compromise. No part of the rule suggests approval of an agreement requiring affirmative votes on a plan is permitted.

B. Case Law Does Not Authorize Settlements Requiring Plan Approvals When Creditors Have Not Evaluated and May Not Even Consider Alternatives

Case law approving settlements which require affirmative plan votes is factually distinguishable and unpersuasive. In *In re Marvel Entertainment Group, Inc.*, 222 B.R. 243 (D. Del.) *rev'd on other grounds*, 140 F.3d 463 (3d Cir. 1998) for instance, the district court (having withdrawn the reference of a bankruptcy case) approved a settlement calling for votes to support a plan. Likewise, in *In re Lion Capital Group*, 49 B.R. 163 (Bankr. S.D. N.Y. 1985), the bankruptcy court approved a settlement of litigation requiring a party to vote in support of a plan.

Marvel and *Lion Capital* are distinguishable from the proposal for plan support represented by the Settlement and Support Agreement. In *Marvel*, the party agreeing to support a creditors' plan was the chapter 11 trustee for the bankruptcy estate. The settlement approved by the District Court in *Marvel* was premised on a chapter 11 trustee's conscious decision to accept a plan as the preferred alternative after extensive efforts to identify alternative plans. *In re Marvel*, 222 B.R. at 249 (concluding the trustee only agreed to the settlement "after concluding that the . . . plan is the best alternative for [the debtor, Marvel]." *Id.* at 250. Similarly, in *Lion Capital*, the creditors were only required to approve a plan that contained the terms of their agreement, not a particular plan. *In re Lion Capital*, 49 B.R. at 177. The settlement did not contain provisions preventing the creditors from considering alternative plans. Thus, to the extent there is case authority to support settlements tied to votes on plans, this authority is premised on a party's right to review alternative plans or, at least, the right to review alternative plans containing required terms.

Here, by contrast, the Settlement and Support Agreement required parties agree to vote for the Proponents' plan of reorganization in exchange for post-petition interest

payments. The Senior Debtorholders agreed to this term before having an opportunity to consider alternative plans which could not have been filed in any event given debtor's exclusivity under 11 U.S.C. § 1121. The agreement forbids creditors from *thinking about* voting for another plan. These provisions are unique and put the Settlement and Support Agreement into a class by itself. No case permits the court to approve a settlement requiring an affirmative plan vote where no opportunity exists to review alternative plans or to consider alternative plans.

II. THE PROPONENTS' SETTLEMENT WITH THE SENIOR DEBTORHOLDERS CANNOT BE APPROVED BECAUSE IT VIOLATES THE BANKRUPTCY CODE

A. The Settlement and Support Agreement Violates the Spirit and Intent of the Bankruptcy Code by Requiring Votes in Favor of Debtor's Plan and Muzzling Dissent

The Settlement and Support Agreement constitutes a trade: creditors will receive interest payments at a negotiated rate in consideration for a commitment to vote "yes" on the Proponents Plan of Reorganization. The United States Trustee challenges the wisdom of approving this provision especially in view of the timing of the agreement. The Proponents reached the agreement with what was then called the "ex-officio" creditor group on January 13, 2002, just a few days before the January 16, 2002 hearing on the Proponents request to extend exclusivity. Settlement and Support Agreement, Preamble and Recitals, p. 2. The final version of the document is dated February 12, 2002, a day prior to the deadline imposed by the Bankruptcy Court on the CPUC for submission of its "term sheet."

The Proponents' obvious intention when they announced the agreement during the original hearing on the Proponents' motion to extend exclusivity must have been to persuade the Bankruptcy Court that any alternative proposal would not be acceptable to creditors. It is important that parties had no meaningful opportunity to review the conditions in connection with the exclusivity hearing.

The carefully timed Settlement and Support Agreement seems intended to co-opt chapter 11 plan processes. At the time the Senior Debtholders originally agreed to support

the Proponents' plan, there was no competing plan and debtor retained exclusivity. The second and final Settlement and Support Agreement of February 12, 2002, was agreed upon just a day prior to the filing of the CPUC's term sheet. These creditors, who must wish desperately to receive some payment on their $3 billion in unsecured claims, literally have given up their rights to even *think* about any plan alternative to the Proponents' plan. The United States Trustee urges the Bankruptcy Court to conclude it is not appropriate for Proponents to require votes on their plan in consideration for the extra statutory payment of unsecured, pre-petition claims.

The agreement further requires that no subscribing creditor may speak against the plan or any disclosure made by the Proponents. The Proponents' attempt to prohibit communication about the case sets a dreadful precedent. Public information about bankruptcy cases is dependent on the intervention of creditors and the Bankruptcy Court's public stature. Allowing a party to buy silence – that is to offer consideration to another party for *not* speaking out – would serve to circumvent the Bankruptcy Code and public integrity.

B. The Settlement and Support Agreement Violates the Bankruptcy Code by Soliciting Votes Prior to the Bankruptcy Court's Approval of the Disclosure Statement

Bankruptcy Code § 1125 flatly prohibits solicitation of votes on a plan of reorganization "unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved . . . by the court as containing adequate information." 11 U.S.C. § 1125(b). There is no approved disclosure statement, nor was there any approved disclosure statement when the parties executed the Settlement and Support Agreement on January 12, 2002. Approving the Settlement and Support Agreement and its mandated creditor affirmation of the Proponents' plan violates § 1125(b). *Century Glove, Inc. v. First American Bank of New York*, 860 F.2d 94, 100 (3d Cir. 1988) (solicitation for votes prior to approval of any disclosure statement unlawful).

Good reason supports the Bankruptcy Code's prohibition on pre-approval solicitation. The Bankruptcy Appellate Panel of the Ninth Circuit described this reasoning:

> Section 1125(b) provides that no one is permitted to "solicit" plan acceptances or rejections until a disclosure statement has been approved by the bankruptcy court and transmitted to creditors along with the proposed plan of reorganization. At a minimum, § 1125(b) seeks to guarantee that a creditor receives adequate information about the plan before the creditor is asked for a vote. *Century Glove*, 860 F.2d at 100 (*citing* the legislative history of § 1125).

Duff v. U.S. Trustee (In re California Fidelity, Inc.), 198 B.R. 567, 571 (Bankr. 9th Cir. 1996). Because there is no approved disclosure statement even today, the Proponents' solicitation for creditor votes as a *quid pro quo* for post-confirmation, pre-confirmation interest payments to creditors was improper.

C. The Settlement and Support Agreement Frustrates the Court's Decision to Terminate Exclusivity in Favor of the California Public Utilities Commission

Approval of the Settlement and Support Agreement is inconsistent with the Bankruptcy Court's decision to authorize the CPUC to file a competing chapter 11 plan. The Settlement and Support Agreement locks the majority of the unsecured creditor class (Class 5 under the Proponent's Second Amended Plan of Reorganization) into voting for the plan. The purpose of filing a competing plan is to present alternative methods of reorganization to creditors. The Proponents' purpose in asking the Bankruptcy Court to approve the Settlement and Support Agreement is to restrict creditors to choosing a single, as yet-unapproved plan of reorganization. The Bankruptcy Court should deny approval of the settlement to give meaning to its decision to allow the CPUC to file a plan.

D. The Settlement and Support Agreement Violates Concepts of Pro-Rata Distribution - Not All Unsecured Creditors Will Be Paid Interest Under the Proponents' Proposal

The Proponent's offer to pay interest does not extend uniformly to the creditor body. The Support and Settlement Agreement requires any "Accepting Senior Debtholder" to agree

to be bound by the terms of the Support and Settlement Agreement in order to receive post-petition interest payments. Obviously, any party who supports a plan other than the Proponent's plan will not be paid post-petition interest. The motion by its terms prohibits participation by creditors with sensitive claims: environmental, fire suppression, tort and chromium claimants. Assuming *arguendo* debtor may pay interest on claims post-petition, this provision violates the Bankruptcy Code's principle of pro rata distribution among similar unsecured claims. 11 U.S.C. §§ 726, 1129 (b)(1); *Official Committee of Equity Security Holders v. Mabey*, 832 F.2d at 302; *In re FCX, Inc.*, 60 B.R. 405, 410-11 (E.D.N.C. 1986).

E. The Settlement and Support Agreement Unlawfully Authorizes the Payment of Post-Petition Fees and Expenses to the Professionals Employed by Unsecured Creditors

The Settlement and Support Agreement requires the Proponents to pay the "reasonable pre- and post- Petition Date costs and expenses of the Senior Debtholders, including the reasonable fees and expenses of counsel for the Senior Debtholders." Settlement and Support Agreement ¶ 19. The Bankruptcy Code and decisional law interpreting the Code do not authorize this result. The Ninth Circuit has held federal law governs entitlement to attorneys' fees when federal law controls the substantive issue before the Court. *Johnson v. Righetti (In re Johnson)*, 756 F.2d 738, 741 (9th Cir.), *cert. denied*, 474 U.S. 828, 106 S.Ct. 88 (1985). There is no general right to attorneys' fees in bankruptcy. *Ford v. Baroff (in re Baroff)*, 105 F.3d 439, 441 (9th Cir. 1997); *cited with approval by Hassen Imports Partnership v. KWP Financial VI (In re Hassen Motors Partnership)*, 256 B.R. 916, 921-922 (Bankr. 9th Cir. 2000) (Montali, J.). The only ostensible legal issue presented by the settlement motion is the interest rate the Proponents ought to use for claims paid from this immensely solvent bankruptcy estate, which can only be seen as a federal question. Absent a bankruptcy statute authorizing fees for bankruptcy related work, no fees should be authorized. *Hassen Motors Partnership*, 256 B.R. at 923 ("the nature of the issues litigated arise solely in bankruptcy and federal bankruptcy attorneys' fee policy is clear . . ."). Thus, no authority exists for the payment of attorneys' fees incurred by counsel for the unsecured creditors.

III. PAYMENT OF UNSECURED CLAIMS PRIOR TO CONFIRMATION IS PROHIBITED

A. Neither Motion Should Be Approved Because The Bankruptcy Code Does Not Authorize Payment of Unsecured, Pre-Petition Claims Outside a Confirmed Plan of Reorganization

Bankruptcy proceedings are governed by statutes. Nowhere in the Bankruptcy Code or its enabling rules did Congress authorize the payment of unsecured pre-petition claims prior to the Bankruptcy Court's approval of a plan of reorganization. The two motions seek approval to pay pre-petition claims and cannot be approved.

The Bankruptcy Code does not by its terms permit distributions to unsecured creditors outside a plan of reorganization approved by the bankruptcy court. *Official Committee of Equity Security Holders v. Mabey*, 832 F.2d 299, 302 (4th Cir. 1987). The Code prohibits "piecemeal, pre-confirmation payments to certain unsecured creditors." *Id;* 11 U.S.C. §§ 1122(a), 1123(a)(4). Payments to creditors absent a confirmed plan also violates Bankruptcy Rule 3021 ("*After confirmation of a plan*, distributions shall be made to creditors whose claims have been allowed . . . .") FED. R. BANKR. P. 3021(emphasis added). It is premature to consider the payment of pre-petition claims.

The structure of the Bankruptcy Code compels what would have seemed an obvious conclusion: payment of claims must await a confirmed plan.

Creditors are parties who hold claims. 11 U.S.C. § 101(5) and (10). Creditors must look to property of the bankruptcy estate for the satisfaction of their claims. Section 541 defines property of the estate broadly to include all interests in real and personal property. 11 U.S.C. § 541(a). To breathe life into the unquestionable principle of pro rata distribution that is the hallmark and genius of a bankruptcy case, the Bankruptcy Code protects the estate from creditor enforcement and collection efforts after the case is commenced. The automatic stay prohibits the "commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arise

before the commencement of the under this title." 11 U.S.C. § 362(a) (1). More specifically, the Bankruptcy Code prohibits "any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. § 362(A) (6) (emphasis added).

Estate property is available for distribution to creditors only upon confirmation. At confirmation, the automatic stay dissolves. 11 U.S.C. § 362(c) (2)(c). The Bankruptcy Code discharges all claims, 11 U.S.C. 1141(d), except the obligations imposed by the confirmed plan. 11 U.S.C. § 1141(a). Property of the estate revests in the debtor, 11 U.S.C. § 1141(b), except to the extent the confirmed plan provides otherwise. 11 U.S.C. § 1141(c). Finally, the debtor "shall carry out the plan and shall comply with any orders of the court." 11 U.S.C. § 1142(a).

Having commenced a bankruptcy case under chapter 11, the Proponents must await confirmation of its plan to pay pre-petition claims.

B. Section 105 Does Not Authorize the Court to Violate the Bankruptcy Code's Prohibition on Payment of Pre-Petition Claims Outside a Confirmed Plan of Reorganization

The Proponents have not cited any specific statutory authority in support of their request to pay pre-petition claims. Instead, the Proponents rely on the court's equity power under section 105(a) for the proposition it is permissible to pay pre-petition, non-priority claims prior to the approval of any disclosure statement let alone a plan. While the Bankruptcy Courts do retain some equity power under section 105(a), the Courts are not empowered to use those equity powers in violation of Congress's intent. Rather, the equity powers were intended to provide the bankruptcy court an avenue for ensuring that Congress's intent is achieved. Consequently, the use of section 105(a) to achieve a result not intended by Congress would constitute an abuse of the court's equity powers.

Section 105(a) of the Bankruptcy Code provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Section 105 only allows the court the ability to use equity to "fulfill some

specific Code provision." *In re Fesco Plastics Corp.*, 996 F.2d 152, 154 (7th Cir. 1993)(*citing Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)). In other words, "when a specific Code section addresses an issue, a court may not employ equitable powers to achieve a result not contemplated by the Code." *Id.* (citing *In re Morristown & Erie R. Co.*, 885 F.2d 98, 100 (3d Cir. 1989)); *see also In re Joint E. & S. Dist. Asbestos Litigation*, 982 F.2d 721, 751 (2d Cir. 1992). No provision of the Bankruptcy Code authorizes pre-confirmation payment of claims. Section 105(a) cannot substitute for a statutory scheme Congress never enacted.

C. No Binding Case Law Supports the Proponents Unusual Request to Pay Pre-Petition Claims Now

1. The "Doctrine Of Necessity" Is Rarely Applied and Is Severely Limited by the Ninth Circuit

Apparently because there is no statutory authority for paying claims prior to confirmation, the Proponents rely principally on the "doctrine of necessity." The so-called doctrine is not widely employed in the Ninth Circuit and has been acknowledged only on a limited basis by the Circuit Court itself. *See In re Adams Apple, Inc.*, 829 F.2d 1484, 1490 (9th Cir. 1987). Tellingly, the only Ninth Circuit case touching on the doctrine, *In re Adams Apple,* has nothing whatever to do with the request here: the Ninth Circuit concluded a creditor who relied on an order of the bankruptcy court cross collateralizing the creditor's pre-petition debts with the debtor's post-petition assets was entitled to the safe harbor of 11 U.S.C. 364(e).

In any event, the "doctrine of necessity" does not apply. The district court in *In re FCX, Inc.* held the doctrine did *not* permit the debtor to pay pre-petition payroll, payroll taxes and grain purchase expenses because doing so would have subordinated some creditors' claims:

> This court finds that by authorizing the payment of pre-petition indebtedness . . . the Bankruptcy Court effectively subordinated the claims of the remaining unsecured creditors. Such subordination is not authorized under the law absent inequitable conduct on the part of these remaining unsecured creditors.

> Section 507(a) does not set forth a priority of payment with respect to the claims authorized by the Bankruptcy Court. By subordinating the claims of the remaining unsecured creditors to these claims, the bankruptcy court has set up a priority within the class of general unsecured creditors not established by Congress.

In re FCX, Inc., 60 B.R. 405, 410-11 (E.D.N.C. 1986). If there is life in the "doctrine of necessity" one might reasonably expect payroll and health insurance for workers to fall within its purview.

The doctrine's limited application is reflected in the Ninth Circuit's *Adams Apple* decision. The court opined that unequal treatment may be appropriate only when "necessary for the rehabilitation, in such contexts as (i) pre-petition wages to key employees; (ii) hospital malpractice premiums incurred prior to the filing; (iii) debts to providers of unique and irreplaceable supplies; and (iv) peripheral benefits under labor contracts." *In re Adams Apple, Inc.*, 829 F.2d at 1490. Not a single one of those factors apply here.

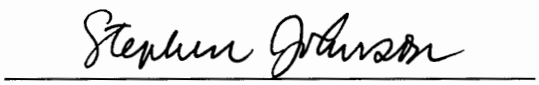
2. Even If the Doctrine of Necessity is Enforceable, It Does Not Apply Here

Many courts have refused to permit payments on pre-petition claims in cases with fact patterns considerably more compelling than presented here. In *Official Unsecured Committee of Equity Security Holders v. Mabey*, the Fourth Circuit ruled that the debtor could not pay the medical expenses of Dalkon Shield victims absent a plan of reorganization. "While one may understand and sympathize with the district court's concern for the Dalkon Shield claimants . . . the creation of the Emergency Treatment Fund at this stage of the Chapter 11 proceedings violates the clear language and intent of the Bankruptcy Code . . . ." 832 F.2d at 302. Likewise, in *In re Structurlite Plastics Corp.*, 86 B.R. 922, 931 (Bankr. S.D. Ohio 1988), the bankruptcy court refused to allow the debtor to pay pre-petition health and welfare claims ("it has not been established that the exigencies of this case demand that the Court authorize payment of medical claims.") No similar urgency or exigency accompanies the Settlement Agreement.

CONCLUSION

The Bankruptcy Court should not approve the two motions to pay pre-petition claims. Neither the Bankruptcy Code nor case law permits a chapter 11 debtor to pay pre-petition claims outside a plan of reorganization. The Proponents' attempt to block serious consideration of an alternative plan by compelling settling parties to vote for the Proponents' plan does not merit approval.

Dated this 20th day of March, 2002



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PROOF OF SERVICE

I, the undersigned, state that I am employed in the City and County of San Francisco, State of California, in the Office of the United States Trustee, at whose direction the service was made; that I am over the age of eighteen years and not a party to the within action; that my business address is 250 Montgomery Street, Suite 1000, San Francisco, California 94104, that on the date set out below, I served a copy of the attached;

U.S. TRUSTEE'S OBJECTION TO MOTIONS TO APPROVE (1) SETTLEMENT AND SUPPORT AGREEMENT (2) PAYMENT OF CERTAIN PRE-PETITION CLAIMS

each party listed below by placing such a copy, enclosed in a sealed envelope, with prepaid postage thereon, in the United States mail at San Francisco, California, addressed to each party listed below.

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I declare under penalty of perjury that the foregoing is true and correct. Executed at San Francisco, California on March 20, 2002.

By:_____
A. LEE